3-2000

The Meaning of "Agreement" under the Sherman Act: Thoughts from the "Facilitating Practices" Experience

George A. Hay
Cornell Law School, george.hay@cornell.edu

Review of Industrial Organization **16:** 113–129, 2000.

The Meaning of "Agreement" under the Sherman Act: Thoughts from the "Facilitating Practices" Experience

GEORGE A. HAY*
Cornell University Law School, Ithaca NY 14853, U.S.A.

I. Introduction

While the Economic Policy Office was involved in a number of interesting and important matters during the six years I was Director (1973–1979), for the most part my involvement in individual investigations and cases was vicarious, i.e., supervising, supporting, and advising the staff economists assigned to the particular matter. The one major exception – a matter in which I became personally involved in an intensive way – was the General Electric (GE)-Westinghouse price signaling matter. In what follows, I provide a brief summary of what transpired in the GE-Westinghouse matter and then trace through some of the longer term consequences of the Department's efforts. I conclude with a discussion of what I regard as a still unsettled issue in antitrust law – the precise legal meaning of "agreement" under Section 1 of the Sherman Act and the relevance of the GE-Westinghouse matter for trying to resolve that dilemma.

II. The *GE-Westinghouse* "Facilitating Practices" Case

For the true origin of the GE-Westinghouse matter,[1] we need to go back to 1960, when GE, Westinghouse, Allis-Chalmers, and four individuals were indicted for fixing the prices of large turbine generators. The criminal case ultimately resulted in the entry of guilty pleas by the corporate defendants and *nolo contendere* by the four individual defendants which in turn resulted in fines and, in the case of one individual, a jail sentence. The companion civil case led to a consent decree against the corporate defendants generally prohibiting price fixing and the kinds of direct

* Edward Cornell Professor of Law and Professor of Economics, Cornell University. The author was Director of The Economic Policy Office 1973–1979.

[1] This summary is taken in large part from the Justice Department's 1977 Competitive Impact Statement in the Ge-Westinghouse matter. *United States* vs. *GE Co.* (1977-1) Trade Cas. (CCH) 712.

communications that had been at the heart of the original conspiracy. Vigorous price competition apparently prevailed in the industry from 1960 into 1963. By 1962, Allis-Chalmers had withdrawn from the market but there was still substantial overcapacity and prices continued to decline. Relatively few sales are made in any year and the pressure to obtain any given order was substantial. Moreover, the product was not homogeneous and, although price books were used, there was little adherence to published prices and considerable discounting occurred on particular projects. However, in 1963 there was an important set of developments that, in the Department's opinion,[2] resulted in a sudden and dramatic reduction in the degree of competition.

Specifically, in May 1963, GE announced a new pricing policy which featured GE's intention to adhere to published prices on all future transactions. The revised policy had a number of elements designed to facilitate the success of the new policy.[3] A key element was a revised price book which contained simplified formulas and procedures for determining the book price of any given turbine generator and a published multiplier to be applied to book prices at any given time so as to determine the actual bid prices for any given project at that time. (For example, the published multiplier for May 1963 was 0.75, which meant that the price that would actually be quoted to any customer would be 0.75 times the book price.) The use of the multiplier permitted GE to make swift changes in price without the complexity inherent in printing an entirely new price book. The combination of the announced no-discount policy, the revised, simplified price book and the use of the published multiplier was that it would be much easier for Westinghouse to know what GE would bid on any given turbine generator project and therefore easier to match GE's price, if it wanted to.

Another key feature of the new policy was the use of "price protection" clauses in all future contracts with customers. The clause operated in such a way that, in the event price was lowered by GE for any given customer, any buyer within the past six months who had paid list price would be given a retroactive discount equal to that given the latest customer. The consequence of the price protection clause was that selective price cuts in individual transactions could not be employed by GE without imposing substantial penalties on itself in the form of retroactive discounts to other customers. The result was to give assurance to Westinghouse that GE would be adhering to its stated policy of not giving discounts.

The net effect of all aspects of the new GE policy was to make it possible for Westinghouse to match exactly GE's prices if it wanted to and to give some

[2] Because the matter was ultimately settled, the economic conclusions in this part of the narrative represent my own perspective and/or that of the Department. The outcome was not litigated and there can be no presumption that the companies involved would necessarily agree with all of the views expressed.

[3] In what follows I identify only some of the major elements of the policy. Readers who are not already familiar with the GE-Westinghouse matter can consult the Competitive Impact Statement or other sources such as George A. Hay, 'Oligopoly, Shared Monopoly, and Antitrust Law', *Cornell Law Review*, **67**, 439 (1982).

assurance to Westinghouse that, in matching GE's published prices, it would not be incurring any risk of being secretly undercut by selective discounts. This did not guarantee, of course, that Westinghouse would in fact match GE's prices but there would be a strong incentive to do so lest GE rescind the new policy and the industry revert to the "cutthroat competition" that characterized the 1960-early 1963 period. In any event, any element of uncertainty was quickly eliminated when Westinghouse published its own price book (essentially equivalent to GE's) and adopted its own price protection clause in 1964. (In the interim, Westinghouse quoted prices based on GE's published price book.) After a few initial hiccups, the policy worked smoothly and with the result that there was a pattern of identical, non-discounted prices for at least the next several years.

Once we thought we had a handle on what had happened and why, what remained was to come up with a legal theory to apply to the case. There was no evidence of any formal communication or agreement between GE and Westinghouse although we were persuaded that a principal purpose of the new policy was to eliminate price competition.[4] Our way of expressing what had happened was to say, in essence, that the independent yet parallel adoption of the new policy by GE and Westinghouse had brought about a meeting of the minds and *facilitated* the elimination of price competition. Since any new antitrust action would be brought under Section 1 of the Sherman Act, it was decided to assert simply that the specific actions taken, coupled with the intent to eliminate price competition, "constituted" an unlawful agreement under Section 1.[5]

III. The *Ethyl* Case

The GE-Westinghouse did not lead immediately to any more facilitating practices cases emanating from the DOJ. However, over at the FTC, Commission staff were investigating the four producers of lead-based antiknock gasoline additives. The staff believed that the producers had managed to eliminate, or at least substantially reduce, price competition but, like GE and Westinghouse, without having entered into any kind of formal cartel-type of agreement. Rather, the focus of the investiga-

[4] GE and Westinghouse denied that their purpose had the intent or the effect to stabilize prices. They claimed that the identical prices were the result of conscious parallelism or the exercise of price leadership by GE and that such interdependent pricing was to be expected in a duopoly where each company's pricing decisions must take into account the likely decisions of the other.

[5] When the Department informed GE and Westinghouse that it was prepared to file a civil antitrust suit and indicated the relief it would seek, the parties offered to settle the matter, and provide all the relief that was desired, so long as it was treated as a modification of the outstanding 1962 consent decree rather than a consent in a new, freestanding, lawsuit. For reasons spelled out in the Competitive Impact Statement (based on the risks inherent in any litigation compounded by the somewhat novel theory employed in this particular matter), the Department accepted the offer and the decree, containing significant restrictions on future behavior, was entered in 1977. However, while the court entered the modification of the consent decree as requested, this required merely that the court find the modification to be in the public interest and there is no significant sense in which the court demonstrated its agreement with the Department's theory of what constitutes an agreement.

tion was on certain “facilitating practices” including contractual provisions similar to the price protection clauses in GE-Westinghouse, which had been adopted by at least the two major producers.[6]

Influenced by the Department’s handling of the GE-Westinghouse matter, the Commission issued a complaint, alleging, in keeping with the FTC’s jurisdiction, a violation of Section 5 of the FTC Act, prohibiting “unfair methods of competition”. While it is clear that any violation of Section 1 of the Sherman Act will also violate the FTC Act, the Commission has generally maintained that FTC Act goes even further than Section 1. In part to establish that proposition, the Commission made a strategic decision not to allege an agreement (tacit or explicit) in the complaint, arguing that the parallel adoption of these facilitating practices with a resulting adverse effect on competition could constitute a violation of Section 5. If the Commission were successful, it felt that an important new weapon against oligopolistic industries would be achieved, a weapon which would not depend on the occasionally metaphysical question of whether or not some kind of agreement existed.[7]

After the hearing, the administrative law judge issued an opinion solidly backing the staff’s theory of the case and granting most of the relief which was sought and the full Commission, sitting as an appellate tribunal, upheld the findings of the administrative law judge. However, when the case was appealed by the producers to the Court of Appeals for the Second Circuit, the Court had difficulty with the several aspects of Commission’s findings.

First, there was not a complete absence of price competition. In particular, the two newer and smaller producers frequently granted discounts. In addition, while the two major producers generally succeeded in avoiding cash discounts, they each made significant non-price concessions to gain additional business. In my view, these findings were not fatal in the sense that standing alone they would not have caused the Second Circuit to overrule the Commission. Nevertheless, the presence of some (perhaps significant) competitive activity did color the Court’s view of the importance of eliminating the challenged conduct.

The second “problem” with the Commission’s case was that it involved a highly concentrated industry, in many ways a classic oligopoly. If the offensive practices were enjoined, how could it be known whether the performance would be signifi-

6 *E. I. DuPont de Nemours & Co.* vs. *FTC*, 729 F.2d 128 (1984). For details and further analysis, see George A. Hay ‘Practices that Facilitate Cooperation: the Ethyl Case’, in J. Kwoka and L. White (eds.), *The Antitrust Revolution*, 3rd ed., 1999. Specifically the practices were: (1) quoting prices on a uniform delivered price basis; (2) announcing price increases to customers and to the press well in advance of the effective date of the price increase; and (3) including in contracts with individual customers a clause requiring the seller to extend to that customer any discount offered to any other customer.

7 Coincidentally, around the time that the case was filed, I left my position at the Justice Department to go to Cornell, and the Commission staff, aware of my role in developing the Department’s position in GE-Westinghouse, retained me to serve as their economic expert in the hearing before the Administrative Law Judge.

cantly improved? The industry found itself in the interesting position of suggesting that, to the extent performance was not "competitive", that was precisely what one would expect in a highly concentrated market. Hence, structure, not conduct, was the villain, and enjoining the challenged conduct would not improve matters. While this argument did not persuade either the administrative law judge or the full Commission, the Second Circuit panel was more receptive to testimony by defendants' experts that, to the extent that performance was less than satisfactory, it could be attributed entirely to the structure of the industry, and that there was no reason to believe that performance would improve if the practices were eliminated.

Third, and perhaps most important, each of the challenged practices had been initiated by the Ethyl Corporation when it was the only producer of lead-based additives, in other words, when it was a monopolist (and presumably unconcerned with coordinating its behavior with that of rivals). The inference drawn from this by the Court was twofold: first, one could not argue that the practices were implemented for the purpose of eliminating competition (although the Commission would argue that there was substantial evidence that the producers recognized that this was their effect); second, given that the practices were implemented when there was no competition to worry about, there was a strong presumption that, at least at that time, there were (potentially significant) efficiencies that resulted from these practices. Hence, eliminating them could not be presumed to be costless.

In light of the earlier findings questioning how much of an improvement one could expect in the competitive vigor of the industry from elimination of the facilitating practices, the Court's perception of the overall net benefits to be gained from their elimination was quite different from that of the administrative law judge or the full Commission. But it was not just the revised cost-benefit analysis which influenced the Court. Perhaps even more important was the perception of unfairness. If these practices were at one time efficient, and were implemented by each of the new entrants in turn primarily for efficiency reasons, was it fair now to condemn the use of the practices simply because the Commission had concluded that, at a given point in time, the competitive costs exceeded the benefits? Does this mean that firms are required to abandon a practice, originally implemented for efficiency reasons, once it is understood that the practices are contributing to the industry's ability to avoid vigorous price competition? Moreover, would such a standard leave the Commission with too much scope for arbitrary rule-making?

Rather than re-argue the rightness or wrongness of the Court's opinion, let me simply offer some observations. First, even a classic cartel will rarely if ever succeed in completely eliminating price competition, and non-price competition, while normally better for consumers than no competition at all, is as likely to be a symptom of the success of the cartel in eliminating price competition as an antidote to the anticompetitive effects of the cartel. Hence, while the extent to which the cartel did not succeed in completely eliminating (price or nonprice) competition might properly be taken into account in the analysis, the presence of some competition should not, by itself, end the inquiry, and the presence of even significant nonprice competition should not cause a court to sanction the elimination of whatever price competition would occur absent the challenged practices.

Second, facilitating practices cases (to lump them all under one heading) will almost by definition occur in a concentrated, i.e., oligopolistic, setting. The fact that the industry might not function perfectly competitively without the facilitating practices does not mean that the practices are harmless. Unfortunately, the degree to which the practices matter will rarely be amenable to any kind of quantitative measurement, especially if they have been in existence throughout the modern history of the industry, thereby rendering a before/after analysis impractical. If these cases are not all to founder on the "we're bad anyway" defense, there must be some scope for an expert to make qualitative inferences from the sequence of events and from the contemporaneous documents and related evidence.

Third, while the possibility of a procompetitive origin for the practices might be evidence relevant to the calculus of whether the costs of the practices exceed the benefits, it needn't be determinative. Moreover, the fairness issue seems much more acute in a private treble damages case under Section 1 (or, should it ever occur, in a criminal prosecution), than in a Section 5 case where the only remedy being sought is an injunction against the continuation of the practices.

Finally, concerns about the power and discretion of the Commission must be tempered by the fact that the whole point of the FTC Act was to create an "expert" body to determine when certain practices should be prevented.

IV. The Aftermath of *Ethyl*

Perhaps as a result of the Second Circuit's decision, little more was heard of "shared monopoly" (another name for the facilitating practices cases) for some time. However, more recently, the concept seems to have been re-awakened, and there have been a few interesting applications.

1. Petroleum Products

The *Petroleum Products* case[8] was a private treble damages action under Section 1 in which the plaintiffs (several states) were appealing a district court's grant of summary judgment to a number of the major oil companies operating in the Western US. The basic allegations were that the oil companies had engaged in certain actions designed to maintain high wholesale and retail prices for gasoline sold at the wholesale level (i.e., from the defendant oil refiners to their customers, referred to as distributers). The principle conduct alleged was that the refiners coordinated dealer discounts from the so-called "tankwagon" price by dissemination of certain information about their wholesale and retail prices.

[8] *In Re Coordinated Pretrail Proceedings in Petroleum Products Antitrust Litigation* 906 F.2d 432 (9th Cir. 1990).

The opinion contains an excellent discussion of oligopoly pricing, including a nice summary of the classic debate between Turner and the "pre-Chicago School" Posner,[9] and an analysis of why interdependent pricing alone cannot be the basis of a Sherman Act violation, even though it results in prices comparable to what a classic cartel would produce.[10] The opinion also sets out nicely a set of circumstances under which a facilitating practices claim will survive in a case brought under Section 1. The allegations were that each of the defendants engaged in various methods of disseminating information concerning their wholesale prices, including press releases (sometimes in advance of the effective date) and "posting" of the prices at various locations that could be accessed by the other defendants. In part because the distributors for each refiner were contractually bound to buy from that refiner (i.e., they could not "shop around" for better prices from other refiners) and in part based on other evidence, the court concluded that there could be no purpose to the dissemination of wholesale prices other than to inform competitors of one another's price movements so as to make it easier for competitors to follow those movements. Under these circumstances, "[a] jury could conclude that the oil companies agreed, *either implicitly or explicitly*, to create market conditions that would facilitate *tacit or express* price coordination.[11] It is significant in assessing how to fit the facilitating practices theory into a Section 1 framework that, while the court suggested that the identified behavior might be circumstantial evidence from which a jury could infer that an explicit agreement had taken place, it would be enough that there was an *implicit* agreement to facilitate *tacit* coordination. While I will develop the semantic aspects of this notion in more detail later on, I read the court to be saying not so much that the jury could infer the existence of an agreement from the evidence but that, in effect, the jury would be permitted to *declare* that the conduct constituted an implicit agreement.[12]

---

9 Donald F. Turner, 'The Definition of Agreement under the Sherman Act', *Harvard Law Review* **75**, 655 (1962) Richard A. Posner, 'Oligopoly and the Antitrust Laws: A Suggested Approach', *Stanford Law Review*, **21**, 1562 (1969).

10 *In Re Coordinated Pretrial Proceedings in Petroleum Products Antitrust Litigation* 906 F.2d 432 (9th Cir. 1990) at 444–445. A brief excerpt: To permit an antitrust violation to be based on the . . . price pattern in this case, without more, would require a company making wholly independent pricing decisions to consider that the possible responses of its competitors might render it liable for treble damages. Similarly, following another company's price increase might very well provide the evidence that a disgruntled customer would need to get to a jury in a treble damage antitrust suit. It thus appears that permitting an inference of conspiracy from the parallel pricing evidence alone would result in an anticompetitive dislocation by distorting independent pricing decisions.

11 Op. cit. at 448 (emphasis added).

12 The evidence on performance is interesting in light of the Second Circuit's Ethyl opinion. Prices apparently followed a "sawtooth" pattern with occasional large (and parallel) increases as discounts were eliminated, followed over a period of time by lower prices as discounts were reinstated. The court felt that the upward movements were large enough that a jury would be justified in concluding that no individual firm would have initiated such large increases without some assurance that others would follow. The fact that the price gains were partially eroded by subsequent discounting (as

2. THE AIRLINE TARIFF PUBLISHING (ATP) CASE

Another recent application of the facilitating practices approach was the recent DOJ case against the major airlines alleging that the airlines signaled one another about possible future prices with the intent and effect of suppressing price competition.[13] All the major airlines are linked by computer and all submit information about their own fares and are able to receive information about fares of rival airlines. This fare information also provides the core of the computerized reservation systems used by travel agents. This linking by itself was not challenged as it is conceded that the airlines have a legitimate need for other airlines' fares since one airline is frequently in the position of selling to one of its own customers a seat on another airline's flight (often, although not always, when the passenger's route requires travel on both airlines to reach the final destination).

What was challenged was that the airlines allegedly used the computer link to communicate intentions about fares to be charged in the future. As the Department's press release indicated: "The airlines engaged in a process that involved repeated exchanges through ATP [the computer network] of price increase proposals and counterproposals, with the effect of raising fares to consumers". A principal allegation was that an individual airline would indicate in the computer that a fare increase on a given route for a given travel period would be implemented, not immediately, but at some time in the near future, e.g., in 7 days. So, to give a very simple example, for a traveler who wanted to go from New York to Los Angeles on a basic coach ticket next April, the fare, if the traveler purchased the ticket today, would be, say $1000 round trip, and that would typically be the same for all airlines which flew that route nonstop. One of the airlines would announce that its own fare, for travel next April, would be going up to $1100, effective in 7 days. For travelers purchasing tickets during the 7 day window, the proposed increase would be irrelevant, as the fares would still be identical, so the airline initiating the fare increase would not expect to lose any sales to its competitors during this period. The 7 day window would allow the first airline to see if its competitors would match the price increase (effective the same day). If so, the new fares would go into effect on the same day for all the airlines. If not, the first airline could simply rescind the proposed increase before the end of the 7 day period, and would not have suffered any lost sales (as it would if it had initiated the price increase effective immediately and its rivals had not matched).

The DOJ claim was that this process allowed airlines to exchange "assurances" about future fares in the same fashion as members of a cartel, sitting around a table in a smoke-filled room, say, in effect, "I'll raise prices next week if you will".

arguably was the case in *Ethyl* as well) did not trouble the court. Nor did the court seem to require any evidence of the overall level of profitability.

[13] *United States* vs. *Airline Tariff Publishing Co.*, 836 F.Supp. 9 (D.D.C. 1993); *United States* vs. *Airline Tariff Publishing Co.*, 1994-2 Trade Cases 70,687 (D.D.C. 1994). See also Severin Borenstein, 'Rapid Price Communication and Coordination: The Airline Tariff Publishing Case (1994)', in J. Kwoka and L. White (eds.), *The Antitrust Revolution*, 3rd ed., 1999.

In more complex scenarios, airlines allegedly "negotiated" the precise amount of the increase if they had different ideas about the most profitable price.[14] The Department claimed that this use of facilitating practices constituted an illegal agreement under Section 1. The matter was settled with a consent decree in which the airlines agreed to eliminate advance announcement of price increases. In other words, all announced price increases would be in effect immediately, until and unless rescinded.

This is not the time to debate the merits of the Department's allegations.[15] However, in light of the Second Circuit's opinion in *Ethyl*, it is interesting to reflect on certain aspects of the DOJ case. First, the case was filed under Section 1; therefore, unlike the FTC's Section 5 complaint, agreement, of one kind or another, is an essential element. Second, the case was filed at a time when several of the defendants were in or near bankruptcy and no one could seriously claim that anyone in the industry was earning supra-normal profits. (Depending on the precise definition of marginal costs, some, if not most, prices were above short-run marginal costs, but that was true before the alleged conspiracy began and is true today. By any historical measure, fare levels were modest.)

Third, in *Ethyl*, almost all price increases which were initiated during the period covered by the complaint were matched by the other competitors. In contrast, in the airline situation there was no such pattern. Many price increases were initiated and later rescinded or scaled back when other airlines didn't match them. While the prices that were actually implemented were uniform (i.e., identical for all airlines), that reflects the high degree of cross-price elasticity of demand and would be true in situations of intense rivalry as well as oligopoly. It is surely the case that no airline, when it decided to initiate a fare increase proposal, had any degree of assurance that competitors would follow.

Fourth, the argument that prices and price levels would be about the same even without the alleged facilitating practices because of the oligopolistic nature of the industry and the homogeneous nature of the product was at least as plausible in the airline situation as it was in Ethyl. Even without advance announcement, rivals would learn of others' pricing decisions instantaneously and reaction would normally be swift. The likelihood of a "stealth" price cut, designed to steal away large chunks of business before rivals could react, was nil.

Finally, the claims for efficiencies from the challenged practice and for the unfairness in attacking them were as plausible as they were in *Ethyl*. The practice of advance announcements was long-standing (originating in an era when fares had to be filed with a regulator before they could be implemented). In addition, while their significance was disputed, there were at least some demonstrable consumer benefits. *Ceteris paribus*, consumers benefit from advance announcement as it allows them to buy tickets during the "window" and thereby avoid the price increase.

[14] Other allegations involved the timing of the removal of discount fares.

[15] I was a consultant for several of the airlines in this matter.

At least some travel agents expressed strong support for advance announcement and concern about the effect of mandating its elimination.

V. Facilitating Practices and the Concept of "Tacit Agreement"

One genera] way to think about these and other facilitating practices cases is to focus on the kinds of defenses that might be raised. This provides a convenient entree into a discussion of the concept of "tacit agreement" and the borderlines between lawful and unlawful conduct. Assuming there is no dispute that the practices have been employed, there are basically four different arguments defendants might make, singly or in combination.

1. "WE'RE NOT BAD"

The first defense argument is that the conduct in question (not the facilitating practices, but the conduct the practices are alleged to have facilitated), while perhaps parallel, is nevertheless perfectly consistent with individual, independent decisions on the part of each defendant. In effect, the defendants are saying that there is no mystery to be explained, no anticompetitive conduct that has been facilitated. Conduct is parallel because all defendants are subject to the same underlying economic forces but that does not mean that the observed conduct is "interdependent". Although plaintiffs will argue that no one firm would have initiated the relevant conduct without some assurance that its competitors would follow, each defendant wants to respond that its conduct is rational *regardless* of what its competitors are doing. (That defendants are aware of what their competitors are doing or expect that competitors will act in a certain way is not critical.)[16]

I take this to have been the core of the defense in the classic *Theatre Enterprises* case[17] where none of the defendant movie distributors was willing to license first run films to the Crest, in suburban Baltimore instead of one of the traditional downtown "first-run" theaters. (The longstanding tradition of area-wide exclusivity during the initial run of a new film made it an either/or proposition and the fact of exclusivity was not questioned by the Court.) Each of the defendant theaters would have asserted in effect that, in light of the characteristics of the Crest and the demographics of its customer base, it would be irrational to give a first run to the Crest, regardless of whether its competitors did likewise. The fact that each distributor may have anticipated that the other distributors would reach the same

[16] This defense is also raised in cases where the plaintiff is trying to establish a traditional agreement (e.g., a conventional hotel-room cartel) using purely circumstantial evidence. In fact, in some cases involving facilitating practices, the plaintiff may not even attempt to distinguish between a classic hotel-room type agreement and a tacit agreement but may simply identify the facilitating practices as part of a list of "plus factors" and request an instruction that an agreement can be inferred from certain conduct not in the defendants' individual self-interest accompanied by one or more plus factors.

[17] *Theatre Enterprises* vs. *Paramount Film Distributing Corp.*, 346 US. 537 (1954).

conclusion is not inconsistent with the claim of independent decision making and may even add plausibility to the claim by showing how each theater was subject to the same underlying business forces.[18]

The same argument was present, at least to some extent, in *Ethyl* and the *ATP* case as well. The parties in *Ethyl* asserted that the homogeneity of the product was sufficient to explain the generally identical list prices and that competition occurred through discounts and non-price concessions (not entirely consistent since, in perfect competition with homogeneous products, the list prices would not leave any margin for additional discounts). In *ATP*, the airlines also argued that high cross-elasticity in a market with good consumer information would generally lead to identical prices and that the overall profits of the industry showed that price levels were not, at least in the aggregate, above competitive levels.[19]

2. 'We're Naturally Bad"

The second defense raised is that the facilitating practices are not responsible for the absence of competition; the fault lies with the industry structure. To the extent that there is an absence of competition (which would of course be disputed by defendants) that is the result of industry structure and there would be no better performance even if the facilitating practices were eliminated.

This was certainly an important element of the defense in *Ethyl*, especially for the two largest firms for whom the lack of price competition was most evident. Their argument was that, given the highly concentrated structure of the market, and the ability to learn quickly (often from customers) of a rival's price increase, the degree of interdependence would be sufficient that a price leader could expect that its pricing initiatives would be followed and could initiate a price increase without great risk of being undermined by competitors' failure to follow or by secret discounts following an increase in nominal prices. The same argument would have been raised by the *ATP* defendants had the case been litigated. Price increases are highly visible; it is easy to follow a leader's price increase if you want to. Moreover, the situation is symmetrical; failure to follow will be quickly noticed and the initial price increase will then be rescinded with no significant loss of business to the initiator of the price increase. Hence there is every incentive to follow a price increase unless the initiator has somehow miscalculated the profit-maximizing price increase, and the potential initiator knows this when calculating the riskiness of

[18] The case is often paired with *Interstate Circuit, Inc.* vs. *United States*, 306 US. 208 (1939), where the Court found that the behavior of each distributor of giving in to demands by the theater chain Interstate Circuit was a radical departure from prior practice and too risky for any one distributor to undertake without some assurance that the other distributors would do likewise. The assurance came in part from the letter to each distributor from Interstate Circuit with "cc:" notation so that each would know that the others were receiving the same proposal.

[19] This may not explain prices on any given city-pair route. Prices for some of those markets have fallen dramatically when new entry occurred, although many of these involved markets previously served by only a single carrier.

initiating a price increase. (The airlines would of course have denied that prices were in fact above competitive levels, at least in the aggregate, but to the extent that they were, it would be blamed on structure.)

This line of defense only works, of course, if it is the case that noncompetitive performance is not actionable under the Sherman Act when it is attributable entirely to industry structure. But this seems to be the current (and, in my view, correct) position of the courts, of which the clearest expression is in *Petroleum Products*. If this is accepted to be the case, two new problems are raised for a plaintiff attempting to build a facilitating practices case under the Sherman Act (and probably under the FTC Act as well). The first is a matter of evidence: how much of a difference did the facilitating practices make to the performance of the industry? The second is a matter of law: and how much of a difference is enough to trigger Sherman Act liability?

3. "Parallel with an Explanation"

A third line of defense argument is that, even assuming that there was some parallel, interdependent conduct, and even assuming that the conduct was facilitated by certain practices engaged in by defendants, the facilitating practices have a legitimate business justification and therefore should not be condemned or allowed to form the nucleus of a Sherman Act (or FTC Act) violation. This was certainly a part of the defense in *Ethyl* and seemed to weigh heavily in the final opinion where the court was reluctant to condemn conduct that, at least at one time, had a plausible business justification, simply because at some later time it may have contributed to a lack of vigorous price competition.[20]

It was also an element of the defendants' argument in *ATP*. There is no question that the fact of advance notice of price increases played a role in the process by which the equilibrium price in a market was reached. Each airline serving a market was able to see that another had initiated a price increase, and the period between the announcement and the time the price increase actually went into effect was a window in which firms could "signal" their acquiescence or "propose" a different price increase. And there is no question that, in the vast majority of cases, by the time price increases actually went into effect, they were generally identical among all the major firms serving a city-pair market.

One could debate whether the overall level of prices was unacceptably high or whether there was ever any "assurance" for a firm initiating a price increase that it would be followed. But it is hard to deny that the airlines in some sense took advantage of the opportunity provided to see if their competitors would be likely to follow a price increase or to indicate their own acceptance of a price increase initiated by others. It is equally clear, however, that the airlines did not create the computerized pricing system for the purpose of facilitating collusion and

[20] And, as suggested earlier, the court's reluctance was supported in part by a belief that there was a lot more price and "near-price" competition than the FTC had initially argued.

that the practice of advance announcement of price increases had *some* plausible degree of business justification. Indeed, in the settlement hearings, several travel agents testified that the remedy being imposed (by consent) would disadvantage their customers by making it more difficult to avoid a pending price increase by purchasing tickets earlier. Moreover, had the case gone to trial, evidence would have been presented to the effect that this practice was also employed on routes where there was only a single carrier, presumably because it was an efficient business practice and certainly not because it facilitated price coordination. (Recall the importance the court in *Ethyl* attached to the significance of the fact that Ethyl used the practices when it was the only firm in the market.)

It is an interesting question how courts should deal with the evidence of business justification. One approach would be a balancing of the anticompetitive consequences against the efficiencies in a rule of reason context. Measurement problems aside, this seems especially plausible in a case brought under Section 5 of the FTC Act, where there are no sanctions and no associated treble damages exposure and the only consequence is an order prohibiting the continuation of the offending practices. In cases under Section 1, however, it might be argued that firms should be immune from liability if the use of the facilitating practices had a plausible (and non-trivial) business justification (i.e., they were not instituted for the purpose of suppressing price competition and would have been employed regardless of any tendency to do so). The court's opinion in *Ethyl* contained elements of this kind of sympathetic approach despite the absence of punitive consequences under Section 5.

4. "We May Be Bad But We're Not Guilty"

The final defense argument is essentially a legal argument going to the core of the "facilitating practices" approach. Assume that the pricing (or other) behavior of the industry is less than vigorously competitive in certain respects (parallel, interdependent conduct which would not be profit-maximizing for any one firm unless rivals followed). Assume further that there is no evidence, even circumstantial, of a conventional agreement but that the lack of effective (price) competition can be attributed, at least in part, to the unilateral, albeit parallel, use of certain facilitating practices (such as advance announcement of price changes). Finally assume that there is no legitimate business justification for the use of those facilitating practices. (This is a pretty close description of the facts, as found by the court, in the *Petroleum Products* case, and of the government's allegations in *ATP*.)

The defense to such an allegation is straightforward: the unilateral, albeit parallel, adoption of facilitating practices does not constitute an agreement for Sherman Act purposes even if the consequence of the use of those practices is the reduction or elimination of competition. According to this line of defense, the plaintiff must establish either that there was an agreement on prices in the first place or else an agreement to use the facilitating practices (which puts the case into the category of cases like *Container*[21] which involve an agreement to exchange price information that in turn leads to the elimination of price competition). The facilitating practices explanation establishes neither. The plaintiffs' response to the line of argument is essentially the Justice Department's (unlitigated) argument in *GE-Westinghouse* – viz., that the Sherman Act extends to tacit or implicit agreements and that the parallel use of facilitating practices for the purpose and with the effect of suppressing (price) competition *constitutes* such an agreement for Sherman Act purposes. In other words, the response defines the concept of agreement so as to include the offensive conduct. While this line of argument seems to be consistent with the Court of Appeals analysis in *Petroleum Products*, it has not been blessed by the Supreme Court in that stark form. Rather the more traditional approach is to argue that an agreement can be proved by circumstantial evidence and that evidence can consist of parallel conduct accompanied by certain plus factors, In such a case, the court is likely to rule that, as a matter of law, the possibility of unlawful agreement cannot be ruled out, and the case will go to the jury with the jury being told that they are free to infer the existence of collusion, either explicit or tacit, from the circumstantial evidence.

Part of the jury instruction is not problematic. Indeed, one can think of it as simply the antitrust equivalent of a good detective story. The pricing behavior is suspicious and one possible explanation is that the parties actually met or at least communicated directly and agreed, in the most traditional sense of the word, to act in parallel. The jury is seeking to determine simply whether the circumstantial evidence makes it more likely than not that such a formal agreement was entered into. The problem comes with the rest of the instruction. Assume the jury is not convinced that a formal agreement has occurred, although it remains convinced that the pricing is not what one would expect in a competitive market. It is told that there is a second option for assigning liability, viz., that there has been a tacit agreement, and that this, too, can be inferred from the circumstantial evidence.

Initially, the jury is likely to think that, like the first part of the instruction, this too is simply a detective mission. A tacit agreement may or may not exist, and the jury is being asked to determine whether it does or not with reference to the circumstantial evidence. The jury instructions may of course refer them to the plus factors as possible bases for an inference. But a thoughtful juror might well pose the following question:

> I understand, your honor, what factors we are entitled to examine in order to infer whether or not there was tacit collusion. But I have a more fundamental question. What precisely do you mean by "tacit collusion"? Can you define it for me so that I know what I am supposed to be looking for?

Of course, jurors rarely ask such questions and more often are left with the possible basis for the inference without knowing what they are actually inferring. Does it mean that, if they find that one or more the plus factors is present, that necessarily

[21] *U.S.* vs. *Container Corporation of America,* 393 I.S. 333 (1969).

means that there has been tacit collusion? Perhaps, but if that were the case, the judge might more properly instruct that the presence of those factors (once the lack of competition has been established) *requires* them to find tacit collusion, not that tacit collusion is merely a permissible inference. That of course goes right back to the Justice Department's definitional approach in *GE-Westinghouse*.[22] If it is not the case that the existence of plus factors (in a situation where there is an established absence of price competition) necessarily constitutes tacit collusion then the puzzled juror is back to asking why not and what distinguishes cases deserving the label of tacit collusion from those that do not. This issue has never been satisfactorily addressed by the courts.

VI. How to Frame a Facilitating Practices Case under the Sherman Act

This discussion takes us back to the more fundamental problem of the definition of tacit collusion discussed at the outset and elsewhere in the paper. Assume, following *Petroleum Products* and ample academic commentary, that pure oligopoly behavior does not violate Section 1, even where the result is supra-competitive prices. Take, however, a less clear cut case of oligopoly, i.e., a case where the structure is less obviously conducive to classic oligopolistic interaction of the type that would not violate the Sherman Act. There may be a larger number of producers or prices may not be transparent (making it less certain that one supplier will be able instantly to match the higher prices of another and less certain that suppliers who have not followed will be detected) or sales may be "lumpy" (making retaliation a less effective threat because of the volume of sales that a temporary non-follower can garner). Assume that in this situation there is not direct evidence of formal collusion, but prices (or other relevant terms) have moved in parallel fashion and there is some indication that performance is not what one would expect in a perfectly competitive market. Moreover, plaintiff can point to the presence of one or more of the so-called "plus factors", including the use of facilitating practices. How can we instruct the jury as to how they should decide whether the observed conduct violates the Sherman Act?

One solution that seems not very helpful would be to invoke some phrase like "meeting of the minds" to identify when defendants have crossed the line since, whatever is meant by "meeting of the minds", it is hard to see why it would not be found in the case of classic oligopoly. In our previous example of pure oligopoly, a firm initiating a price increase may have a very large degree of confidence that its rival will follow, but that confidence derives from the industry structure, not from any specific actions taken by either firm.

Having given the matter some thought, I am convinced that the difference between unlawful "tacit collusion" and lawful oligopolistic interdependence is not to

[22] Of course, this problem is circumvented in cases brought under Section 5 of the FTC Act where, at least according to the *Ethyl* court, an agreement (whether tacit or explicit) is not an essential ingredient.

be found in any phrase that describes the state of mind of the industry participants. Once we are outside the boundary of a formal agreement, whatever degree of "assurance", "meeting of the minds", "conscious commitment to a common scheme", etc., that exists in a situation of tacit collusion can exist to the same extent in a situation of (lawful) classic oligopoly. Rather, if there is to be a category of unlawful tacit collusion which is to be distinguished from classic oligopoly, the difference must lie, not in the state of mind of the competitors, but on the specific elements of behavior that brought about that state of mind. Hence a proper instruction would say something like the following:

> Tacit collusion is to be distinguished from pure oligopolistic interdependence. The latter exists where the noncompetitive performance is largely, if not entirely, the result of industry structure and the firms have taken no unlawful steps in furtherance of the elimination of competition among themselves. In contrast, when I use the terms "tacit collusion" or "implicit conspiracy" I mean that the firms have inappropriately undertaken specific actions in order to bring about the reduction or elimination of competition. [The court might then describe the kinds of practices that might constitute unlawful facilitating practices.] I instruct you that, if you find that the firms have consciously and deliberately undertaken one or more of these practices with the primary purpose and the effect of substantially reducing competition among themselves, their conduct constitutes unlawful tacit collusion and you should find them liable for having violated Section 1 of the Sherman Act. If, on the other hand, you find that the practices alleged by plaintiff to have been undertaken by defendants were undertaken entirely or primarily for legitimate business purposes, or that the practices did not have the effect of substantially reducing competition among them, you should find that there has been no violation of Section 1.

VII. Conclusion

While I am not wedded to the precise format of the proposed jury instruction, the basic point is a simple one. The phrase "tacit collusion", where it is intended to constitute unlawful conduct, has no natural or unique meaning. Hence telling a jury that it may infer tacit collusion from circumstantial evidence or even from certain types of circumstantial evidence (e.g., the "plus factors") is not helpful since, unlike inferring a formal agreement from circumstantial evidence (where the jury is asked to determine whether there actually must have been a meeting or some other direct method of communication resulting in agreement), the jury has no real way of knowing what they are looking for. By default, the "plus factors" become the violation, not the circumstantial evidence that a violation has occurred. If certain kinds of conduct (e.g., facilitating practices) are to be the essence of the violation, the court should be up front about it. The message that the use of facilitating practices could, under certain circumstances, *constitute* an unlawful agreement was of course at the core of the DOJ Competitive Impact Statement in the GE-Westinghouse matter. That message has been somewhat lost in the succeeding years as the focus shifted to the question of when the use of certain apparent facilitating practices could be defended or whether the conduct cried out for any nefarious explanation at all. But if use is going to be made of the concept of facilitating practices in the future, sooner or later the core question must be addressed. Now that we have more experience with alleged facilitating practices, the time may be ripe.

References

Borenstein, Severin (1994) 'Rapid Price Communication and Coordination: The Airline Tariff Publishing Case', in J. Kwoka and L. White, eds., *The Antitrust Revolution*, 3rd ed., 1999.

Hay, George A. (1994) 'Practices that Facilitate Cooperation: the *Ethyl* Case', in J. Kwoka and L. White, eds., *The Antitrust Revolution*, 3rd ed., 1999.

Posner, Richard A. (1969) 'Oligopoly and the Antitrust Laws: A Suggested Approach', *Stanford Law Review*, **21**, 1562.

Shenefield, John H. (1978) 'Antitrust Division Memorandum on Identification and Challenge of Parallel Pricing Practices in Concentrated Industries', *Antitrust and Trade Regulation Reporter*, **874**, (BNA) F-1.

Turner, Donald F. (1962) 'The Definition of Agreement under the Sherman Act', *Harvard Law Review*, **75**, 655.